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June 24, 1994

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

HAND DELIVER

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: ET Docket No. 93-266
Ex Parte Presentations

Dear Mr. Caton:

In accordance with Section 1.1206(a)(1) of the Commission's rules, the attached written ex parte letters concerning the above-referenced docket were submitted today to Mr. Donald Gips of the Office of Plans & Policy, Mr. Byron Marchant of Commissioner Barrett's office, Ms. Lauren Belvin of Commissioner Quello's office, and Mr. Richard Welch of Commissioner Chong's office. Attached are two copies of the letters.

Should you have any questions concerning this matter, please do not hesitate to contact the undersigned directly.

Sincerely,



Mark J. O'Connor

Enclosures

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

June 24, 1994

Mr. Donald Gips
Department Chief, Office of Plans & Policy
Federal Communications Commission
1919 M Street, N.W., Room 822
Washington, D.C. 20554

Re: Pioneer's Preference Program
ET Docket No. 93-266
Ex Parte Presentation

Dear Mr. Gips:

The future of the pioneer's preference program and the existing pioneers given the new competitive bidding authority was the subject of last October's NPRM in ET Docket No. 93-266. As such, this is a non-restricted proceeding. We are writing this letter to outline some of the key issues, especially in light of the recent speech by Vice President Al Gore. We were pleased to see that the Administration supports the pioneer's preference program, but we have deep concerns over the use of "discounts" as an incentive for inspiring small entrepreneurs to take the risks or attract the capital necessary to achieve new innovations. We strongly urge that any payment mechanisms for at least small business pioneers be related to the success of the pioneer's business, and not to the price some other business is willing to pay for RF spectrum. Several payment mechanisms could possibly achieve this, as noted below.

Before addressing the multiple problems with discounts and the advantages of other payment methods, it is important to show the fallacy of *some* of the arguments for charging pioneers. Some parties have argued that pioneers should be charged because the advent of auctions changed the "competitive dynamics," whereas under lotteries everyone received their license for free. Several parties have complained that moving from lotteries to auctions gives the pioneers a competitive cost advantage that didn't exist before. This is completely false.

Absolutely nothing changed with respect to the issue of how much non-pioneers would pay for their licenses simply because the licensing mechanism changed from lotteries to auctions. Before auctions, every company which seriously wanted a license knew it would have to buy the licenses from the lottery winners. Indeed, lotteries were criticized as "private auctions." Dozens if not hundreds of licenses awarded by lottery were purchased by the giant cellular companies

from the lottery winners. Those giant cellular companies are being disingenuous when they now argue that if lotteries had been used for PCS that they would have received their PCS licenses for free. The probability that any party would win a lottery license of their choice in an area where a pioneer's preference license had been awarded is infinitesimally small. 60,000 lottery applications were received in just two days in the 220 MHz docket for 5 Kiloherzt channels. Imagine how many applications would have been submitted for 30 MHz channels.

Thus, this "new competitive unfairness" issue is a complete illusion. If lotteries had been kept, would the FCC be considering charging the pioneers 80% of what the lottery winners sold their licenses for to the RBOCs? Obviously not.

A second false argument is the assertion that the cost advantages to a pioneer for receiving a "free" license will make the non-pioneers businesses economically unviable. One RBOC called this advantage "insuperable." These parties are implying that the price they have to pay in an auction renders their businesses uncompetitive. But, no one is charging these non-pioneers for their licenses, they are bidding on them. The government is not setting a price on their license, as bidders they set the price. Whatever price is set by the market will take into account the pioneers situation, as well as the fact that there are cellular licensees already in that market which received their license for free and have a 10 year head start.

A third fallacy is that pioneers receive their licenses for free. The truth is that the pioneer's process requires pioneers to invest their capital at the time it is riskiest without any guarantee of obtaining an allocation for their ideas, let alone a license. Those bidding in an auction are bidding riskless dollars. Either they win the license or they do not spend any money.

The fourth fallacy is that the pioneer's program takes money away from the government.. The truth is that the program will increase total revenue to the Treasury. Clearly, the pioneer's preference program brought numerous serious parties into the process of solving the problems facing PCS four years ago. Whatever price the total PCS spectrum is auctioned for today it will be more because of the pioneer's preference program. Perhaps more importantly, the licensing process was expedited by many years. Cellular licensing took 14 years with only 3 parties conducting experiments. PCS took 3 1/2 years with over 50 would be pioneers conducting experiments.

Nonetheless, going forward there is a strong desire on the part of many to charge pioneers something for the spectrum. The problem is that "discounts" don't really work in the context of a pioneers preference program. Discounts end up setting the pioneer's payment based on how other parties value the spectrum, even if those other parties have infrastructure advantages which

far exceed the value of a "discount." to a pioneer. We believe royalties or a similar scheme are the only mechanisms which tie the pioneer's payments to the actual business of the pioneer rather than the business of some other company. The traditional objections against royalties can be overcome in the pioneer's preference program, especially for small businesses. First, the primary objection to the use of royalties in an auction is because there is no way to compare two royalty bids, let alone a royalty bid versus an upfront cash bid. But there are no bid problems with applying a royalty to a dispositive license award to a pioneer. Second, the number of pioneers will always be very small and thus be manageable. Third, conditions can be specified at the time of the application if royalties are to be used which prevent ambiguities and gaming. Fourth, especially with small businesses, the royalty can be set on all revenue of the entity receiving the preference in order for it to be eligible to use a royalty mechanism.

In establishing and reconsidering the pioneer's preference program, the Commission considered granting "comparative" or "weighted" preferences and rejected this. Specifically, the FCC ruled:

"A weighted preference would provide no assurance to the innovative party that it would, in fact, receive a license. As we stated in the Report and Order, any approach that would permit an innovator to be foreclosed from a license by another party would undermine the value of the preference and thereby fail to accomplish its public interest purpose. Consequently, we affirm that the preference will be dispositive." Memorandum Opinion and Order, GEN Docket No. 90-217, 8 FCC Rcd. 1808, 1809 (1992).

A discount does not guarantee a license to a pioneer. Certainly, a bidding discount doesn't even come close to assuring a license. Even a dispositive award of a license to a pioneer, with the requirement to pay X% of what some other party pays, will result in many small business pioneers failing to obtain a license because they cannot justify the price. Only a royalty or similar scheme, such as per subscriber fees, which tie payments to the success of the pioneer's business, will fulfill the policy goal of rewarding innovation with the guarantee of a license.

The problems with discounts can be seen with a few examples. Long distance companies have the ability to use RF spectrum to bypass the LEC access charges. With 45% of their **revenue** at stake they can afford to pay multiples of what a start-up company could ever justify for a license. The same is true with respect to a company that has other key infrastructure assets, whether it is LEC, a cellular company, a cable TV company, a company with retail distribution, etc. A start-up company doesn't own a long distance business such that it can reap these structural benefits. Even a scheme which provided for installment payments would not address

Mr. Donald Gips
Federal Communications Commission
June 24, 1994
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the fact that a small business could not justify the same total price as another company which can exploit unique assets.

Other implementation problems exist with "discounts". The spectrum bands are not necessarily identical within any given docket and thus there may be no exact comparables. Consider PCS, where different numbers of OFS incumbents occupy each of the PCS bands as well as different numbers of public safety users which have 5 years to move. If auctions are held sequentially and a "comparable band" is auctioned early to set the pioneer's price, what happens if in later auctions the licenses go for much less, or go for free? The pioneer would have been better off without a preference. What happens if the purchaser of a "comparable" license later defaults? What happens if, in two years, the purchaser goes bankrupt or never builds a system because they overpaid? What happens if the "discount" is less than what the pioneer spent to develop the innovation? How is a small business pioneer supposed to raise money before the auctions to finance its innovations when it cannot tell its investors how much the license will cost or whether they could ever justify the price that some other company might pay?

All of these problems can be solved with a royalty or per subscriber fee that ties the pioneer's payments to the pioneer's business.

We will be submitting shortly more detailed proposals for implementing non-discount based payment mechanisms. We urge you to consider the above issues and not lose sight of the purpose of the pioneer's program in changing the rules going forward.

In accordance with the Commission's ex parte rules, two copies of this letter will be submitted this day to the Commission's Secretary.

Sincerely,



Douglas G. Smith
President, Omnipoint Corporation

Enclosures

Pioneer's Program Summary

- The U.S. Treasury Will Raise More Money with the PCS Auctions Because of the Pioneers Preference Program.
- The Pioneers Preference Program Increased the Value of PCS to the Government Because it Incited Over 200 Experimental License Requests for PCS and Unprecedented Innovation, Compared to Only 5 Experimental Requests in the 15 months Before the Pioneers Program.
- The Pioneers Preference Program Expedited the Rule Making on PCS By Years: PCS Took Less Than 4 years, Cellular Took 14 Years.
- Every Year Which PCS was Expedited Increases Total Future GNP by Billions of Dollars.
- Only 1/10th of 1% of the Licenses were Awarded to the PCS Pioneers.
- Only 3/10th of 1% of the PCS RF Spectrum was Awarded to the PCS Pioneers.
- Only 5% of the "Pops" x RF Spectrum was Awarded to the PCS Pioneers.
- 6 Rounds of Filings and Comments were Held in the Broadband PCS Pioneers Program. Plus Peer Review of Hundreds of Pages of Experimental Reports.
- A special FCC NPRM Was Undertaken to Re-evaluate the Pioneers Program After the Auction Legislation.
- 84% of the 46 Comments on the NPRM Supported the Pioneers Program.
- Only 4 Giant Telecom Companies - Which Received Licenses For Free - Opposed the FCC.
- No Party Sought Reconsideration of the FCC's Final Decision to Treat the PCS Pioneers Under the Original Rules, i.e. Without Payment.
- In Total, Over a Period of Years, Thousands of Pages of Comments and Replies Have Been Submitted Regarding the PCS Pioneers Preference Decision. Congress was Integrally Involved and Kept Up To Date.
- The FCC Unanimously Affirmed and Reaffirmed Their PCS Pioneers Decision Three Times In Light of a Full Record.



ARGUMENTS FOR CHARGING PIONEERS ARE BASED ON FALSE ASSUMPTIONS

- Auctions did not change any competitive pricing issues of Pioneers vs. Non-Pioneers.
- Non-Pioneers would have bought licenses from lottery winners.
 - 60,000 lottery applications in 2 days for 5 KiloHz licenses at 220 MHz
 - Southwestern Bell, for example, bought 20 cellular licenses awarded by lottery
- There is no "unfair" or "insuperable" competitive disadvantage to Non-Pioneers.
 - Non-Pioneers set the price of their licenses through bidding
 - No one is telling Non-Pioneers how much to pay, thus the market will establish competitive prices for PCS licenses
 - Long distance companies and those with infrastructure assets have far greater "cost advantages" than Pioneers
 - With 2,500 licenses, many may go "free" if no bid

WHY DISCOUNTS WILL NOT WORK FOR PIONEERS IN THE FUTURE

A "Discount" Is Not What Induced The Risks, Investments, and the
Disclosure of Proprietary Ideas

The Award Is A "Guarantee to a License ... Not Subject to Competing
Applications"

A "Discount" Does Not Guarantee A License To A Pioneer

A "Discount" Does Not Reflect The Differing Value Put On A License For
Reasons Other Than Innovation or Even Offering the Pioneer's Service,
For Example Long Distance Co.'s Can Use Their Licenses For Bypass

How Does A Small Pioneer Raise Money to Bid Against Giants With A
Discount

Installment Payments Still Force the Pioneer to Value the License For
Purposes Other Than Its Business

Small Business Pioneer's Would Have No Way to Raise Money Before an
Auction Because They Would Have No Idea What the License Would
Cost or Whether They Would Actually End Up With a License

POSSIBLE SOLUTIONS

Any Charging Mechanism Should Be Related to the Pioneer's Business and
Use of the Spectrum Not to What Others Would Use the Spectrum For

Royalties or Similar Schemes Are Critical In Order To Tie Payments to the
Pioneer's Success Rather Than the Speculation of Others

We further stated in the *Report and Order* that an initial determination of entitlement to a pioneer's preference would be made at the time a notice of proposed making (NPRM) was issued proposing rules for a service or modifications to rules in an existing service. Finally, we stated that no preference would be awarded in proceedings in which an NPRM addressing a service or technology had been issued prior to release of the *Report and Order* adopting the pioneer's preference.

DISCUSSION AND DECISIONS

Need for More Specific Preference Criteria and Nature of Preference

9. NAB argues that the criteria for a pioneer's preference should be clarified. According to NAB, this will prevent the Commission from being inundated with preference requests and judicial review proceedings initiated by those denied a preference or by competitors to those receiving a preference. NAB also maintains that we should provide specific examples of the kinds of improvements that might warrant a preference. Further, in NAB's view, the preference should at most be comparative rather than a guarantee of a license. NAB asserts that a guarantee of a license would be an excessive benefit and could lead to spectrum requests for unneeded services.

7. *Decision.* As discussed in the *Report and Order*, it is necessary to make the standard for a pioneer's preference as specific as possible to provide guidance to innovators and financial institutions as to when a preference might be granted. However, the standard must be somewhat flexible in order to be applicable to the various types of proceedings in which it might be used. To enunciate an inflexible standard would narrow the scope of the preference to such an extent that some genuinely innovative proposals would not qualify. Such a standard would undermine our goal in this proceeding of encouraging the development of innovative proposals for new radio services and technologies. While we cannot forecast either the number of preference requests or the number of requests for judicial review of our preference decisions, we nonetheless continue to believe that the standard we have established is sufficiently specific without being so inflexible as to undermine its purpose of fostering new spectrum-based technologies and services.

8. With regard to NAB's contention that the preference should be comparative rather than a guarantee of a license, we considered and rejected this argument in the *Report and Order*. A weighted preference would provide no assurance to the innovative party that it would, in fact, receive a license. As we stated in the *Report and Order*, any approach that would permit an innovator to be foreclosed from a license by another party would undermine the value of the preference and thereby fail to accomplish its public interest purpose. Consequently, we affirm that the preference will be dispositive. However, we emphasize that a preference will generally be limited to one geographic area and the preference holder will face competition from other service providers.

Requirement for an Experiment

9. NAB argues that a showing of technical feasibility in lieu of an experiment is insufficient justification for awarding a preference. In NAB's view, requiring only a technical showing could mean that a preference would be based on mere speculation that a service might work and result in technically inferior services, since there would be no mechanism for comparing the technical proposals of applicants competing for a preference. On a related issue, SCI argues that the rules are unclear as to the showing that must be made before the Commission will issue an initial determination that a preference for a particular applicant is warranted. Specifically, SCI argues that the *Report and Order* does not clearly state whether, in situations in which the prospective pioneer also requests experimental authority, a preference will be withheld until those experiments actually have been performed. SCI requests that we clarify this issue by ruling that, while the completion of experiments may be a prerequisite to the final grant of a preference, a conditional preference may be awarded prior to commencement of those experiments.

10. *Decision.* We continue to believe that while performance of an experiment generally will be extremely beneficial, since in most cases a substantially different technology or service will be proposed, it should not be absolutely required as a prerequisite to obtaining a preference. We disagree with NAB that requiring only a technical showing means that a preference could be based on mere speculation that a technology might work and result in technically inferior services. We intend to analyze technical showings as rigorously as the results of experiments to ensure that a preference applicant's proposed new service or technology is viable and worthy of a preference.

11. Regarding SCI's request to clarify our standard, we believe that a preference applicant relying upon an experiment rather than a written technical submission at least must have commenced its experiment and reported to us preliminary results in order to be eligible for award of a conditional preference. If the applicant conducts an experiment to demonstrate the technical feasibility of its proposal, the findings of that experiment will be one of the major components that we will use in determining whether a tentative preference is warranted. If no experimental results are available we would not have the information needed to award a tentative preference. While we recognize that an experimental license applicant may have to wait 90 or more days to have its application approved, there also is a time period between the submission of a preference request and the award of a tentative preference. Therefore, the preference applicant should have ample time to initiate its experiment and obtain at least preliminary results.² Accordingly, we find that a tentative preference will not be awarded to an applicant that has not submitted a demonstration of technical feasibility nor commenced an experiment and reported to us at least preliminary results.

² Under our revised preference deadline procedure, a preference request must be submitted prior to consideration of the relevant NPRM. See paragraph 26, *infra*.

license in the authorized service. We will permit the person receiving a preference to select the one area of licensing that it desires to serve. The area selected will depend on how the Commission report and order defines the area of operation under its rules, city or region. In cases where the Commission adopts rules defining service areas different than had been proposed or anticipated by the petitioner, we will permit a choice of eventual licensing (for the pioneer) to be made (after) a report and order is adopted in the proceeding. In general, we are adopting an approach such that the pioneer's preference would be awarded for the area defined for the service under our licensing rules. For example, if we decide that a service should be licensed on a Metropolitan Statistical Area (MSA) basis, the pioneer's preference, if awarded, would apply to the MSA designated by the innovator.

54. We will generally not grant a nationwide preference or a preference for more than one service area. Our goal is to create an incentive for innovation by establishing a certainty that an otherwise qualified applicant will be able to participate in the proposed service. We must balance this goal against our long-standing desire to encourage diversity in communications services, wherever possible. We believe that granting a pioneer a preference for one area will generally be sufficient incentive to bring its ideas to the Commission. Where a service is inherently nationwide, we will consider granting a nationwide preference. However, we do not believe that granting a preference for more than one service area would usually be necessary to accomplish the purpose of adopting a pioneer's preference.

Multiple Preferences/Deviation of Proposal From Final Service Rules

55. The *Notice* sought comment on whether the Commission should consider granting multiple preferences where more than one party submits a petition to allocate spectrum and request for a pioneer's preference for the same type of service, and the service lends itself to multiple licensees. It further sought comment on the extent to which an innovator's proposal could deviate from the final rules adopted for a service and still qualify for a preference. For example, the Commission might determine to locate the service in a different frequency band than that proposed by the innovator. Similarly, the Commission might allocate less spectrum than requested by the innovator or might modify the service as a result of information developed in the proceeding.

56. Commenting parties express various opinions as to whether multiple preferences should be permitted and how much deviation should be permitted for an innovator to qualify for a preference. Some commenting parties contend that the Commission should award a preference only to the first qualified applicant for a service. To permit otherwise, it is explained, will encourage the filing of competitive applications that will delay the introduction of service. Other parties maintain that, in appropriate circumstances, more than one preference should be awarded. They claim that the possibility of multiple preferences may stimulate diverse technical approaches to a proposed service. Virtually all commenting parties recognize that it is inevitable that a final Commission report and order will differ in some respects from an initiating proposal. They argue that final rules need not precisely track the proposal for a preference to be granted. Indeed, it is noted, often a proposal is refined during the course

of a proceeding. Only if the Commission decision is substantially different, it is argued, should the preference be lost. A more liberal view expressed is that it is enough if the applicant has made a valuable contribution for a preference to be awarded.

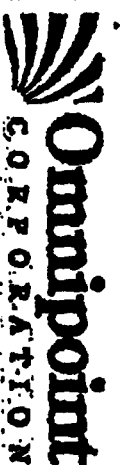
57. *Decision.* Our objective in this proceeding is to provide incentive to innovators to either bring forth new services or to increase the efficiency of existing services. We are convinced that this objective can best be accomplished by giving otherwise qualified innovative parties an assurance that their efforts to develop a new service or technology will result in a benefit if adopted in some general form by the Commission. We believe that in many services there will be a single, clear-cut innovator, while in other services, it will be difficult to distinguish among several innovative parties. In the latter situations, we find it appropriate to award preferences to each applicant that can meet the eligibility standard for being awarded a preference. For example, if the Commission adopts rules that combine aspects of two or more applicants' proposals or rules that permit the use of two or more applicants' proposed technologies, we believe that more than one preference would be warranted. We recognize that there is a potential drawback to awarding multiple preferences in that some parties who are not truly pioneers may be encouraged to file "copycat" applications in an attempt to gain a preference.¹² However, we will look very carefully at each application to ensure that what is being proposed meets the standard set forth in paragraph 47, *supra*. To the extent that an application is deficient in this respect, no preference will be awarded. Also, in some cases where multiple preference requests are filed, it may better serve the public not to grant any of them.

58. We note that a situation could arise in which the final rules adopted for a service would be so different from all of the service proposals that any preference would be inappropriate. Nevertheless, while we will continue to review our decisions on a case-by-case basis, it will be our general policy to award a preference to any otherwise qualified innovator meeting our standard even if the Commission's final rules for the service are not identical to the innovator's original proposal. However, if the modifications are so significant that the particular innovator does not meet the eligibility standard, we will not award a preference to that innovator. We believe that such an approach should result in providing innovators with the certainty necessary to garner financial support in a timely manner and should ensure that the benefits of the new service can be realized expeditiously by the public.

Timing of Preference Award

59. In the *Notice*, the Commission proposed to set forth its initial determination regarding whether to grant a preference request at the time a notice of proposed rule making (NPRM) on the innovator's proposal is issued. Relatively few commenting parties address this proposal. Some parties support it while others recommend that all action on whether to grant a preference be deferred until the report and order stage of the proceeding.

60. Those arguing in favor of granting a preference when an NPRM is issued point out that early designation is necessary to provide the innovator with continued incentive to pursue its project and raise necessary capital.



COMMENTS/REPLIES

ON 2 GHz PCS

PIONEERS PREFERENCE NPRM

Keep Pioneers

Preference

- 5 Investment Houses
- Small Business Admin.
- 3 RBOCs
- 3 Independent Cellular Co.
- 5 Manufacturers
- 6 "Independents"
- 3 Tentative PPs
- 9 "Appellants"

In Favor of

Retractive Repeal

- GTE, BellSouth, Nentel
- 3 RBOCs
- 3 Independent Cellular Co.
- 3 Manufacturers
- 3 Tentative PPs
- 9 "Appellants"

End PP

No Retractive

Repeal

- Southwestern Bell
- Henry Geller

35 In Favor of Pioneers Preference

3 For Retractive Repeal

2 for No Pioneers Preference,
No Retractive Repeal

84% Favored Keep Pioneers Program
and NO Retractive Repeal